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Reporting the Results of Operations—

*Reporting the Effects of Disposal of a Segment of
a Business, and Extraordinary, Unusual and
Infrequently Occurring Events and Transactions*

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*Issued by the Accounting Principles Board of the
American Institute of Certified Public Accountants*

INTRODUCTION

1. In APB Opinion No. 9, *Reporting the Results of Operations*, issued in 1966, the Board concluded that net income for a period should reflect all items of profit and loss recognized during the period except for certain prior period adjustments. The Opinion further provided that *extraordinary items* should be segregated from the results of ordinary operations and shown separately in the income statement and that their nature and amounts should be disclosed.

2. Financial reporting practices in recent years indicate that interpreting the criteria for extraordinary items in APB Opinion No. 9 has been difficult and significant differences of opinion exist as to certain of its provisions. The Board is also concerned with the varying accounting treatments accorded to certain transactions involving the sale, abandonment, discontinuance, condemnation, or expropriation of a segment of an entity (referred to in this Opinion as disposals of a segment of a business).

3. The purposes of this Opinion are (1) to provide more definitive criteria for extraordinary items by clarifying and, to some extent, modifying the existing definition and criteria, (2) to specify disclosure requirements for extraordinary items, (3) to specify the accounting and reporting for disposal of a segment of a business, (4) to specify disclosure requirements for other unusual or infrequently occurring events and transactions that are not extraordinary items.

DISCUSSION

4. Some accountants believe that financial statements would be improved by presenting an all-inclusive income statement without separate categories for continuing operations, discontinued operations and extraordinary items. In their view, the use of arbitrary and subjectively defined categories tends to mislead investors and to invite abuse of the intended purposes of the classifications. They believe, therefore, that basically an income statement should reflect only the two broad categories,

(a) revenue and gains and (b) expenses and losses. They also believe that investors would be better served by reporting separately the primary types of revenue and expense, including identification of items that are unusual or occur infrequently. Alternatively, sufficient information relating to those items should be otherwise disclosed to permit investors to evaluate their relevance. These accountants believe that such changes should be implemented at the present time.

5. Other accountants believe that the income statement is more useful if the effects of events or transactions that occur infrequently and are of an unusual nature are segregated from the results of the continuing, ordinary, and typical operations of an entity. They also believe that the criteria for income statement classification should relate to the environment in which an entity operates. In their view the criteria in APB Opinion No. 9, paragraph 21, for determining whether an event or transaction should be reported as extraordinary lack precision. Accordingly, they conclude that the criteria should be clarified and modified to provide that to be classified as an extraordinary item an event or transaction should be both unusual in nature and infrequent in occurrence when considered in relation to the environment in which the entity operates. They also believe that to enhance the usefulness of the income statement (a) the results of continuing operations of an entity should be reported separately from the operations of a segment of the business which has been or will be discontinued and (b) the gain or loss from disposal of a segment should be reported in conjunction with the operations of the segment and not as an extraordinary item. They further believe that material events and transactions that are either unusual or occur infrequently, but not both, should be adequately disclosed.

6. Still other accountants agree in part with the views described in paragraph 5 but believe that a combination of infrequency of occurrence and abnormality of financial effect should also result in classifying an event or transaction as extraordinary.

APPLICABILITY

7. This Opinion supersedes paragraphs 20 through 22, paragraph 29 insofar as it refers to examples of financial statements, and Exhibits A through D of APB Opinion No. 9. It also amends paragraph 13 and footnote 8 of APB Opinion No. 15, *Earnings per Share*, insofar as this Opinion prescribes the presentation and computation of earnings per share of continuing and discontinued operations. This Opinion does not modify or amend the conclusions of APB Opinion No. 11, *Accounting for Income Taxes*, paragraphs 45 and 61, or of APB Opinion No. 16, *Business Combinations*, paragraph 60, with respect to the classification of the effects of certain events and transactions as extraordinary items. Prior APB Opinions that refer to the superseded paragraphs noted above are modified to insert a cross reference to this Opinion.¹

OPINION

Income Statement Presentation and Disclosure

8. *Discontinued Operations of a Segment of a Business.* For purposes of this Opinion, the term *discontinued operations* refers to the operations of a segment of a business as defined in paragraph 13 that has been sold, abandoned, spun off, or otherwise disposed of or, although still operating, is the subject of a formal plan for disposal (see paragraph 14). The Board concludes that the results of continuing operations should be reported separately from discontinued operations and that any gain or loss from disposal of a segment of a business (determined in accordance with paragraphs 15 and 16) should be reported in conjunction with the related results of discontinued operations and not as an extraordinary item. Accordingly, operations of a segment that has been or will be discontinued should be reported separately as a component of income before extraordinary items and the cumulative effect of accounting changes (if applicable) in the following manner:

¹ This Opinion amends APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, to the extent that it describes an extraordinary item.

Income from continuing operations before income taxes ²	\$xxxx	
Provision for income taxes	xxx	
Income from continuing operations ²		\$xxxx
Discontinued operations (Note —):		
Income (loss) from operations of discon- tinued Division X (less applicable income taxes of \$——)	\$xxxx	
Loss on disposal of Division X, including provision of \$—— for operating losses during phase-out period (less applicable income taxes of \$——)	xxxx	xxxx
Net Income		<u>\$xxxx</u>

Amounts of income taxes applicable to the results of discontinued operations and the gain or loss from disposal of the segment should be disclosed on the face of the income statement or in related notes. Revenues applicable to the discontinued operations should be separately disclosed in the related notes.

9. Earnings per share data for income from continuing operations and net income, computed in accordance with APB Opinion No. 15, should be presented on the face of the income statement.³ If presented, per share data for the results of discontinued operations and gain or loss from disposal of the business segment may be included on the face of the income statement or in a related note.

10. *Extraordinary Items.* The Board has also reconsidered the presentation of extraordinary items in an income statement

² These captions should be modified appropriately when an entity reports an extraordinary item and/or the cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, *Accounting Changes*. The presentation of per share data will need similar modification.

³ The presence of a common stock equivalent or other dilutive securities together with income from continuing operations and extraordinary items may result in diluting one of the per share amounts which are required to be disclosed on the face of the income statement—i.e., income from continuing operations, income before extraordinary items and before the cumulative effect of accounting changes, if any, and net income—while increasing another. In such a case, the common stock equivalent or other dilutive securities should be recognized for all computations even though they have an anti-dilutive effect on one of the per share amounts.

as prescribed in APB Opinion No. 9, and reaffirms the need to segregate extraordinary items for the reasons given in paragraph 5 of this Opinion and paragraph 19 of APB Opinion No. 9.

11. In the absence of discontinued operations and changes in accounting principles, the following main captions should appear in an income statement if extraordinary items are reported (paragraphs 17-19 of APB Opinion No. 9):

Income before extraordinary items ⁴	\$xxx
Extraordinary items (less applicable income taxes of \$_____) (Note __)	xxx
Net income	<u><u>\$xxx</u></u>

The caption *extraordinary items* should be used to identify separately the effects of events and transactions, other than the disposal of a segment of a business, that meet the criteria for classification as extraordinary as discussed in paragraphs 19-24. Descriptive captions and the amounts for *individual* extraordinary events or transactions should be presented, preferably on the face of the income statement, if practicable; otherwise disclosure in related notes is acceptable. The nature of an extraordinary event or transaction and the principal items entering into the determination of an extraordinary gain or loss should be described. The income taxes applicable to extraordinary items should be disclosed on the face of the income statement; alternatively disclosure in the related notes is acceptable. The caption *net income* should replace the three captions shown above if the income statement includes no extraordinary items.

12. Earnings per share data for income before extraordinary items and net income should be presented on the face of the income statement, as prescribed by APB Opinion No. 15.

Accounting for the Disposal of a Segment of a Business

13. For purposes of this Opinion, the term *segment of a business* refers to a component of an entity whose activities rep-

⁴ This caption should be modified appropriately when an entity reports the cumulative effect of an accounting change.

resent a separate major line of business or class of customer. A segment may be in the form of a subsidiary, a division, or a department, and in some cases a joint venture or other non-subsidiary investee, provided that its assets, results of operations, and activities can be clearly distinguished, physically and operationally and for financial reporting purposes, from the other assets, results of operations, and activities of the entity. Financial statements of *current and prior* periods that include results of operations prior to the measurement date (as defined in paragraph 14) should disclose the results of operations of the disposed segment, less applicable income taxes, as a separate component of income before extraordinary items (see paragraph 8). The fact that the results of operations of the segment being sold or abandoned cannot be separately identified strongly suggests that the transaction should not be classified as the disposal of a segment of the business. The disposal of a segment of a business should be distinguished from other disposals of assets incident to the evolution of the entity's business, such as the disposal of part of a line of business, the shifting of production or marketing activities for a particular line of business from one location to another, the phasing out of a product line or class of service, and other changes occasioned by technological improvements. The disposal of two or more unrelated assets that individually do not constitute a segment of a business should not be combined and accounted for as a disposal of a segment of business.

14. *Definition of Measurement and Disposal Dates.* For purposes of applying the provisions of this Opinion, the *measurement date* of a disposal is the date on which the management having authority to approve the action commits itself to a formal plan to dispose of a segment of the business, whether by sale or abandonment. The plan of disposal should include, as a minimum, identification of the major assets to be disposed of, the expected method of disposal, the period expected to be required for completion of the disposal, an active program to find a buyer if disposal is to be by sale, the estimated results of operations of the segment from the measurement date to the

disposal date, and the estimated proceeds or salvage to be realized by disposal. For purposes of applying this Opinion, the *disposal date* is the date of closing the sale if the disposal is by sale or the date that operations cease if the disposal is by abandonment.

15. *Determination of Gain or Loss on Disposal of a Segment of a Business.* If a loss is expected from the proposed sale or abandonment of a segment, the estimated loss should be provided for at the measurement date.⁵ If a gain is expected, it should be recognized when realized, which ordinarily is the disposal date. The determination of whether a gain or a loss results from the disposal of a segment of a business should be made at the measurement date based on estimates at that date of the net realizable value of the segment after giving consideration to any estimated costs and expenses directly associated with the disposal and, if a plan of disposal is to be carried out over a period of time and contemplates continuing operations during that period, to any estimated income or losses from operations. If it is expected that net losses from operations will be incurred between the measurement date and the expected disposal date, the computation of the gain or loss on disposal should also include an estimate of such amounts. If it is expected that income will be generated from operations during that period the computation of the gain or loss should include the estimated income, limited however to the amount of any loss otherwise recognizable from the disposal; any remainder should be accounted for as income when realized. The Board believes that the estimated amounts of income or loss from operations of a segment between measurement date and disposal date included in the determination of loss on disposal should be limited to those amounts that can be projected with reasonable accuracy. In the usual circumstance, it would be expected that the plan of disposal would be carried out within a period of one year

⁵ If financial statements for a date prior to the measurement date have not been issued, and the expected loss provides evidence of conditions that existed at the date of such statements and affects estimates inherent in the process of preparing them, the financial statements should be adjusted for any change in estimates resulting from the use of such evidence. (See Statement on Auditing Standards No. 1, *Codification of Auditing Standards and Procedures*, paragraph 560.03.)

from the measurement date and that such projections of operating income or loss would not cover a period exceeding approximately one year.⁶

16. Gain or loss from the disposal of a segment of a business should not include adjustments, costs, and expenses associated with normal business activities that should have been recognized on a going-concern basis up to the measurement date, such as adjustments of accruals on long-term contracts or write-down or write-off of receivables, inventories, property, plant, and equipment used in the business, equipment leased to others, deferred research and development costs, or other intangible assets. However, such adjustments, costs, and expenses which (a) are clearly a *direct* result of the decision to dispose of the segment and (b) are clearly not the adjustments of carrying amounts or costs, or expenses that should have been recognized on a going-concern basis prior to the measurement date should be included in determining the gain or loss on disposal. Results of operations before the measurement date should not be included in the gain or loss on disposal.

17. Costs and expenses *directly* associated with the decision to dispose include items such as severance pay, additional pension costs, employee relocation expenses, and future rentals on long-term leases to the extent they are not offset by sub-lease rentals.

18. *Disclosure.* In addition to the amounts that should be disclosed in the financial statements (paragraph 8), the notes to financial statements for the period encompassing the measurement date should disclose:

- (a) the identity of the segment of business that has been or will be discontinued,
- (b) the expected disposal date, if known (see paragraph 14),
- (c) the expected manner of disposal,

⁶ When disposal is estimated to be completed within one year and subsequently is revised to a longer period of time, any revision of the net realizable value of the segment should be treated as a change in estimate (see paragraph 25).

- (d) a description of the remaining assets and liabilities of the segment at the balance sheet date,⁷ and
- (e) the income or loss from operations and any proceeds from disposal of the segment during the period from the measurement date to the date of the balance sheet.

For periods subsequent to the measurement date and including the period of disposal, notes to the financial statements should disclose the information listed in (a), (b), (c), and (d) above and also the information listed in (e) above compared with the prior estimates.

Criteria for Extraordinary Items

19. Judgment is required to segregate in the income statement the effects of events or transactions that are extraordinary items (as required by paragraph 11). The Board concludes that an event or transaction should be presumed to be an ordinary and usual activity of the reporting entity, the effects of which should be included in income from operations, unless the evidence clearly supports its classification as an extraordinary item as defined in this Opinion.

20. Extraordinary items are events and transactions that are distinguished by their unusual nature *and* by the infrequency of their occurrence. Thus, *both* of the following criteria should be met to classify an event or transaction as an extraordinary item:

- (a) *Unusual nature*—the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates. (See discussion in paragraph 21.)

⁷ Consideration should be given to disclosing this information by segregation in the balance sheet of the net assets and liabilities (current and noncurrent) of the discontinued segment. Only liabilities which will be assumed by others should be designated as liabilities of the discontinued segment. If the loss on disposal cannot be estimated within reasonable limits, this fact should be disclosed.

- (b) *Infrequency of occurrence*—the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. (See discussion in paragraph 22.)

21. *Unusual Nature.* The specific characteristics of the entity, such as type and scope of operations, lines of business, and operating policies should be considered in determining ordinary and typical activities of an entity. The environment in which an entity operates is a primary consideration in determining whether an underlying event or transaction is abnormal and significantly different from the ordinary and typical activities of the entity. The environment of an entity includes such factors as the characteristics of the industry or industries in which it operates, the geographical location of its operations, and the nature and extent of governmental regulation. Thus, an event or transaction may be unusual in nature for one entity but not for another because of differences in their respective environments. Unusual nature is not established by the fact that an event or transaction is beyond the control of management.

22. *Infrequency of Occurrence.* For purposes of this Opinion, an event or transaction of a type not reasonably expected to recur in the foreseeable future is considered to occur infrequently. Determining the probability of recurrence of a particular event or transaction in the foreseeable future should take into account the environment in which an entity operates. Accordingly, a specific transaction of one entity might meet that criterion and a similar transaction of another entity might not because of different probabilities of recurrence. The past occurrence of an event or transaction for a particular entity provides evidence to assess the probability of recurrence of that type of event or transaction in the foreseeable future. By definition, extraordinary items occur infrequently. However, mere infrequency of occurrence of a particular event or transaction does not alone imply that its effects should be classified as extraordinary. An event or transaction of a type that occurs frequently in

the environment in which the entity operates cannot, by definition, be considered as extraordinary, regardless of its financial effect.

23. Certain gains and losses should not be reported as extraordinary items because they are usual in nature or may be expected to recur as a consequence of customary and continuing business activities. Examples include:

- (a) Write-down or write-off of receivables, inventories, equipment leased to others, deferred research and development costs, or other intangible assets.
- (b) Gains or losses from exchange or translation of foreign currencies, including those relating to major devaluations and revaluations.
- (c) Gains or losses on disposal of a segment of a business.
- (d) Other gains or losses from sale or abandonment of property, plant, or equipment used in the business.
- (e) Effects of a strike, including those against competitors and major suppliers.
- (f) Adjustment of accruals on long-term contracts.

In rare situations, an event or transaction may occur that clearly meets both criteria specified in paragraph 20 of this Opinion and thus gives rise to an extraordinary gain or loss that includes one or more of the gains or losses enumerated above. In these circumstances, gains or losses such as (a) and (d) above should be included in the extraordinary item if they are a direct result of a major casualty (such as an earthquake), an expropriation, or a prohibition under a newly enacted law or regulation that clearly meets both criteria specified in paragraph 20. However, any portion of such losses which would have resulted from a valuation of assets on a going concern basis should not be included in the extraordinary items. Disposals of a segment of a business should be accounted for pursuant to paragraph 13 and presented in the income statement pursuant to paragraph 8 even though the circumstances of the disposal meet the criteria specified in paragraph 20.

24. *Materiality.* The effect of an extraordinary event or transaction should be classified separately in the income statement in the manner described in paragraph 11 if it is material in relation to income before extraordinary items or to the trend of annual earnings before extraordinary items, or is material by other appropriate criteria. Items should be considered individually and not in the aggregate in determining whether an extraordinary event or transaction is material. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action that otherwise meets the two criteria in paragraph 20 should be aggregated to determine materiality.

*Adjustment of Amounts
Reported in Prior Periods*

25. Circumstances attendant to disposals of a segment of a business and extraordinary items frequently require estimates, for example, of associated costs and occasionally of associated revenue, based on judgment and evaluation of the facts known at the time of first accounting for the event. Each adjustment in the current period of a loss on disposal of a business segment or of an element of an extraordinary item that was reported in a prior period should not be reported as a prior period adjustment unless it meets the criteria for a prior period adjustment as defined in paragraph 23 of APB Opinion No. 9. An adjustment that does not meet such criteria should be separately disclosed as to year of origin, nature, and amount and classified separately in the current period in the same manner as the original item. If the adjustment is the correction of an error, the provisions of APB Opinion No. 20, *Accounting Changes*, paragraphs 36 and 37 should be applied.

*Disclosure of Unusual
or Infrequently Occurring Items*

26. A material event or transaction that is unusual in nature or occurs infrequently but not both, and therefore does not meet both criteria for classification as an extraordinary item, should be reported as a separate component of income from continuing

operations. The nature and financial effects of each event or transaction should be disclosed on the face of the income statement or, alternatively, in notes to the financial statements. Gains or losses of a similar nature that are not individually material should be aggregated. Such items should not be reported on the face of the income statement net of income taxes or in any manner inconsistent with the provisions of paragraphs 8 and 11 of this Opinion or in any other manner that may imply that they are extraordinary items. Similarly, the earnings per share effects of those items should not be disclosed on the face of the income statement.⁸

EFFECTIVE DATE

27. This Opinion shall be effective for events and transactions occurring after September 30, 1973. Events and transactions that were reported as extraordinary items in statements of income for fiscal years ending before October 1, 1973 should not be restated, except that a statement of income including operations of discontinued segments of a business may be reclassified in comparative statements to conform with the provisions of Paragraphs 8 and 9 of this Opinion and the Board encourages such reclassification. In addition, the accounting for events and transactions that have been reported previously for the fiscal year in which September 30, 1973 occurs may be restated retroactively to comply with the provisions of this Opinion, and the Board encourages such restatement. Differences in classification of the effects of events and transactions in the financial statements of the current and any prior periods presented should be disclosed in notes to the financial statements.

The Opinion entitled "Reporting the Results of Operations" was adopted by the assenting votes of fifteen members of the Board, of whom three, Messrs. Horn-gren, Norr, and Welsch, assented with qualification. Messrs. Bows and Watt dissented.

⁸ Exceptions to the final two sentences of this paragraph are specified in the following AICPA industry audit guides: *Audits of Banks*, p. 36; *Audits of Fire and Casualty Insurance Companies*, p. 66; and *Audits of Stock Life Insurance Companies*, p. 89.

Mr. Horngren assents to this Opinion because it provides somewhat more definitive criteria for pinpointing extraordinary items than have existed to date. However, he agrees with the substance of paragraph 4. Separate identification of abnormal, unusual, or infrequent items is the primary need. Whether these items are classified as extraordinary or ordinary is a secondary issue. Furthermore, he is unconvinced that any criteria can be formulated which provide a workable distinction between extraordinary and ordinary items.

Mr. Norr assents because he believes the Opinion will reduce the frequency of use of the extraordinary item category. In order to provide stewardship he believes all items should go through the income statement with supplemental disclosure of results of discontinued operations, paragraph 8. He believes that the criteria created in this Opinion for extraordinary items, unusual and infrequent (paragraphs 20-22), are subjective and unworkable. He does not believe earthquakes, expropriations or prohibitions under new laws (paragraph 23) are extraordinary. He believes that the extraordinary category has resulted in a proliferation of abuses, particularly debits, comparable to direct entries to surplus. He believes the investor is best served by single line identification of unusual items. In that way there is stewardship for past events and the reader may predict which items may not recur. Thus, the subject of forecasting is a companion piece and is a vital adjunct to an all-inclusive income statement.

Mr. Welsch assents to the issuance of this Opinion because he believes it will reduce the differences in the classification of certain events and transactions as extraordinary. He also believes that it will reduce the varying accounting treatments accorded certain transactions involving the disposal of a segment of an entity. Mr. Welsch does not agree that the addition of another subjectively defined category and the attendant earnings per share complications will further serve the investor. He believes that the all-inclusive income statement, coupled with comprehensive disclosure requirements, would better serve the investor

for the reasons given in Paragraph 4 of this Opinion. He believes this change should be implemented at the present time.

Mr. Bows dissents to this Opinion because in his view it will cause serious erosion and confusion in efforts to achieve an informative and proper presentation of results of operations. This deterioration will occur because ordinary operating results will be blurred by inclusion of nonoperating, unusual and nonrecurring items that affect net income for a given period. For example, material gains or losses from retirement of debt, from major devaluations, from sales of nonoperating capital assets, from major storms or floods, and from litigation unrelated to current operations are to be included in the determination of "income from continuing operations" rather than being set out separately on a net-of-tax basis below such operating results. The statement of income will present a distorted picture of ordinary operating results and thus will be less useful to readers than if ordinary operating results were clearly distinguished from truly extraordinary items on a net-of-tax basis and with a separate indication of their earnings per share effect.

Mr. Watt dissents to this Opinion because it virtually eliminates extraordinary items yet perpetuates the format which implies that only ordinary events and transactions are included in income before extraordinary items. To him the inclusion in "ordinary" income, for example, of expenses, net of tax, directly associated with the disposal of a business (and in the format required by paragraph 8), and gains and losses from sale or abandonment of a plant without adjustment for related income taxes (paragraph 23d), obscures current operating performance and will result in readers of financial statements questioning the usefulness of the complex format described in paragraph 8. He also believes that, in addition to the criteria for extraordinary items prescribed in paragraph 20, the Board should have recognized that the quality of being extraordinary can be derived from a combination of infrequency of occurrence (paragraph 20b) and abnormality of size, without regard to the nature of the event or transaction (paragraph 20a). This view is described in paragraph 6 of the Opinion.

NOTES

Opinions of the Accounting Principles Board present the conclusions of at least two-thirds of the members of the Board.

Board Opinions need not be applied to immaterial items.

Covering all possible conditions and circumstances in an Opinion of the Accounting Principles Board is usually impracticable. The substance of transactions and the principles, guides, rules, and criteria described in Opinions should control the accounting for transactions not expressly covered.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive.

Rule 203 of the Institute's Rules of Conduct prohibits a member from expressing his opinion that financial statements are presented in conformity with generally accepted accounting principles if the statements depart in a material respect from such principles unless he can demonstrate that due to unusual circumstances application of the principles would result in misleading statements—in which case his report must describe the departure, its approximate effects, if practicable, and the reasons why compliance with the established principles would result in misleading statements.

Pursuant to resolution of Council, this Opinion of the APB establishes, until such time as they are expressly superseded by action of FASB, accounting principles which fall within the provisions of Rule 203 of the Rules of Conduct.

Accounting Principles Board (1973)

PHILIP L. DEFLIESE

Chairman

DONALD J. BEVIS

ALBERT J. BOWS

MILTON M. BROEKER

LEO E. BURGER

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ROBERT L. FERST

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CHARLES B. HELLERSON

CHARLES T. HORNGREN

LOUIS M. KESSLER

DAVID NORR

GEORGE C. WATT

GLENN A. WELSCH